

INITIAL EXAMINATION PROCEDURES

OVERVIEW

The following procedures provide guidance to examiners conducting those activities that commence upon entering a financial institution for a compliance/CRA examination. These procedures are required as part of the examination process.

Examination Objective(s)

The objectives of the initial examination activities are to:

Provide specific guidance on fundamental examination tasks

Help direct and focus the examination

Alert the examiner to potential problems or areas of concern

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**MEETING
WITH
EXAMINATION
STAFF**

Meet with Examination Staff

1. Hold a meeting with the examination staff preceding the on-site review or the first day of the on-site examination.

The Examiner-in-Charge (EIC) should discuss the following:

Results of pre-examination planning (PEP)

Scope of the examination

Anticipated length of examination

Job assignments/tasks to be completed by each examiner

Work schedule

Planned or anticipated absences of examination staff during the examination, including: scheduled training; annual, sick, or credit (compensatory) leave

**COMPLIANCE
DOCUMENT
REQUEST**

Review Compliance Document Request Materials

1. Prior to the entrance meeting with management, review the materials requested on the Compliance Document Request (CDR) during PEP.
2. Identify any requested materials not provided so that they may be requested again of management.

**ENTRANCE
MEETING
WITH
MANAGEMENT**

Meet with Management

1. Schedule the entrance meeting with management during PEP.

This meeting should take place as soon as possible after entering the financial institution to conduct the on-site portion of the examination.
2. Ask that persons responsible for managing the daily operations of the financial institution attend.

**ENTRANCE
MEETING
WITH
MANAGEMENT
(cont'd)**

These individuals may include:

President and/or chief executive officer

Compliance and Community Reinvestment Act (CRA) officer(s)

Any other persons identified by the financial institution's management

3. Prepare an agenda for discussion that includes:

An overview of the examination process

The names of FDIC examiners and work schedule

Anticipated length of the examination

The EIC's accessibility throughout the on-site examination to discuss any issues or concerns relating to the examination or FDIC policy and practices in general

The identity of the individual(s) who is/are the primary contact person(s) for examination related issues

Work space requirements and access to the financial institution's files and personnel

The files and documents to be reviewed and the general purpose of the reviews

The issues identified during PEP, including questions related to the materials forwarded to the field office in response to the Compliance Information Request (CIR)

The materials requested during PEP as part of the CIR or the CDR which had not been provided by the financial institution

An explanation of the FFIEC's Community Contacts Procedures

An explanation of the closing management meeting procedures as outlined in the Closing Management and Board Meetings section of this manual

Date of next board of directors/trustees meeting

Management should be advised that, depending upon the examination findings, the FDIC may attend this meeting.

**ENTRANCE
MEETING
WITH
MANAGEMENT
(cont'd)**

A confirmation that management will or will not request the FDIC to review investments and community services for CRA

*NOTE: Small banks may receive an "Outstanding" without consideration of investments and community services; however, these areas will not be reviewed during the examination **unless** management requests the FDIC to do so. Investments and services can only be used to upgrade a "Satisfactory" to an "Outstanding" rating nor can they downgrade a "Satisfactory" rating. Investments and services cannot be used to upgrade a "Needs to Improve" or a "Substantial Noncompliance" to a "Satisfactory" rating.*

**BUSINESS
PLAN REVIEW**

Review Business Plan

1. Review the business plan that outlines short- and/or long-range plans for the institution's future.

These may be called strategic, business, or operating plans. In such cases, a review of the financial institution's plan early in the examination process could be beneficial.

The examiner's review should note the following:

New loan and deposit products

Projected growth of the financial institution

Any other information that would impact the examination

**MEETING
MINUTES
REVIEW**

Review Official Minutes from Meetings

1. Review the official minutes from meetings of the financial institution's board of directors/trustees, loan review, and any compliance and CRA committee meetings since the last examination.

NOTE: CRA committee meeting minutes need not be reviewed for small institutions or for other institutions opting to follow the revised rule prior to the July 1, 1997 mandatory implementation date.

**MEETING
MINUTES
REVIEW
(cont'd)**

2. Determine the following:

Extent of board oversight/involvement in assuring compliance with consumer protection and fair lending laws and regulations (for example, the commission and review of internal and external audits)

Training of directors and senior management regarding consumer protection/fair lending issues

The board's rationale for implementing or modifying loan policies or other consumer compliance related policies or procedures

Circumstances under which changes were made in the key staff of the institution

Records or indications of negative comments on rejected loan applications during loan committee or any other meeting

Any such records must be traced to the specific loan file to assure that no unlawful disparate treatment or discrimination in violation of the Equal Credit Opportunity or Fair Housing Acts was involved in the denial

Board review of the CRA Statement and community delineation on an annual basis

NOTE: Not applicable for small institutions or to other institutions opting to follow the revised rule prior to the July 1, 1997 mandatory implementation date.

Consideration of new loan or deposit products

Extent of the financial institution's loan marketing program

Self-analysis of lending patterns (at institution's option)

Approval of, and rationale for, branch openings and closings

**AUDIT
REPORTS AND
SELF-
EXAMINATION
S**

Review Audit Reports and Self-Evaluations

1. Review consumer compliance and fair lending audit reports generated by internal and external sources to ensure:

Scopes of audits are adequate

**AUDIT
REPORTS AND
SELF-
EXAMINATION
S (cont'd)**

Identified weaknesses have been appropriately addressed

A determination that the scope and thoroughness of any internal or external review meets the purposes of FDIC examination procedures may allow for a limited scope of review in specific areas.

2. Use audit reports and other self-evaluations to assess:

Effectiveness of the financial institution's policies, procedures, and practices

Extent to which staff complies with outstanding policies and procedures

In addition, audit reports may also reveal the adequacy of staff training.

Exception: Do not request fair lending self-testing reports (or results). If however, a financial institution voluntarily provides documentation of its fair lending self-testing, review the findings. Read the Self-Testing for Fair Lending Compliance section below for more information.

NOTE: A financial institution's audit or self-evaluation of loan files, internal policies, and training material may indicate differences in the treatment of applicants that could constitute a violation of the fair lending laws.

3. Determine the validity and thoroughness of the financial institution's self-assessment and consider this when performing a fair lending review.

4. Based upon a review of the audit or self-evaluation report, identify problem areas cited so that management's corrective actions can be assessed.

5. Determine whether exceptions corrected by the financial institution will be included in the Report of Examination (ROE).

**AUDIT
REPORTS AND
SELF-
EXAMINATION
S (cont'd)**

If audit and self-evaluation reports indicate that identified exceptions have been corrected by the financial institution prior to the beginning of the compliance examination, use discretion in determining whether or not to include these exceptions in the ROE. If included, remarks should give the institution credit for corrections made.

Consider the following:

The nature of the identified exceptions

The circumstances surrounding the occurrence and correction of these exceptions

The proximity (in terms of time) between the audit and the examination

The overall compliance posture of the financial institution

6. Identify specific consumer protection and fair lending laws and regulations, or areas of the financial institution's operations, not reviewed during audits or self-evaluations and determine the reason why these matters were not covered.

7. Discuss with management before the exit meeting any serious deficiencies found during the examination that should have been captured during an audit.

8. Include a discussion of any audit weaknesses in the ROE.

Self-Testing for Fair Lending Compliance

As previously stated, the FDIC encourages financial institutions to conduct self-assessments.

The FDIC distinguishes between self-tests and self-evaluations. A financial institution can use pre-application testing to uncover instances of prohibited discrimination against individuals protected under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA).

In a **self-test**, a lender hires or otherwise arranges for "testers" or "shoppers" to visit financial institutions posing as prospective loan applicants. While they do not actually complete a loan application, testers do experience the important pre-application phase of the loan process. After discussing loan possibilities, testers objectively document how they were treated and the information given to them by the financial institution's personnel. A self-test generates information that would not otherwise be available to the lender or to the FDIC in the normal course of business.

**AUDIT
REPORTS AND
SELF-
EXAMINATION
S (cont'd)**

**Self-Testing for
Fair Lending
Compliance
(cont'd)**

Examiners are not to ask to review a financial institution's self-testing results. If, however, a financial institution voluntarily provides documentation of its self-testing efforts, the examiner should review the findings.

Procedures
1. If a financial institution voluntarily provides documentation of its fair lending self-testing, review the findings.

**Self-Evaluation
for Fair Lending
Compliance**

In a **self-evaluation**, the financial institution reviews information maintained in:

Actual loan files
Home Mortgage Disclosure Act loan application registers (HMDA-LARs)
Policy manuals
Training materials
Audit reports

Unlike self-testing, self-evaluations are based on information about actual loan applicants.

**LOAN
POLICIES**

Prepare to Evaluate Loan Policies
1. Determine, prior to the review of loan files, whether: Loan policies and procedures are sufficiently extensive to safeguard against violations of consumer protection and fair lending laws and regulations <i>NOTE: Loan policies may be formal (written) or informal (verbal).</i>
2. If informal: Obtain loan requirements and applicant qualifications, including any specific characteristics, through discussions with management and the lending staff

**LOAN
POLICIES
(cont'd)**

Review loan files and interview appropriate personnel to clarify or confirm loan information, particularly those issues relating to the fair lending portion of the examination

3. Evaluate the financial institution's loan policies in light of the questions listed below. Note the applicable or related laws and regulations referenced in the parenthesis.

Relevant Questions

Has the institution established any lending standards? (ECOA, FHA)

Are the loan underwriting standards/criteria specific and non-subjective? (ECOA, FHA)

Do any of the specific standards potentially exclude persons afforded protection under ECOA or FHA? (ECOA, FHA)

Do any of the specific credit standards potentially exclude minority applicants or neighborhoods? The following are examples of standards that, although neutral on their face, may have the effect of preventing, or discouraging, applications from minority applicants or applicants of minority neighborhoods:

- Minimum unit or building lot size
- Maximum property age
- Minimum property value or loan amount
- Minimum employment stability
- Past due credit limitations regarding duration and severity
- Debt-to-income ratios
- Loan-to-value ratios
- "Desirable" versus "undesirable" credits/borrowers
- Requirements for prior banking relationships
- Requirements for validating credit history (for example, a report from a credit reporting agency, rental checks, paid utility bills) (ECOA/FHA)

The lending standards noted above may also have an impact on an institution's lending to low- and moderate-income applicants and neighborhoods. If the CRA review indicates that an institution has a small presence or weak penetration among low- and moderate-income applicants and/or neighborhoods, reviewing underwriting standards may help explain the low penetration.

**LOAN
POLICIES
(cont'd)**

Under what circumstances does the financial institution **not require** a written loan application? (ECOA, FHA)

If applicable, how would the financial institution adjust or "gross-up" non-taxable income, public assistance payments and some retirement income to determine qualifying income and debt ratios? (ECOA, FHA)

How does the financial institution determine collateral value? Under what circumstances are appraisals ordered? (ECOA, FHA)

What applicant characteristics prompt the institution to order a credit history from a credit reporting bureau? (ECOA, FHA, Fair Credit Reporting [FCR])

How does the financial institution determine interest rates?

-- What flexibility or discretion does the lending officer have?

-- Does the institution have a policy that allows for overages?

NOTE: An overage is an amount of money charged to the borrower for a particular mortgage loan product in excess of a minimum base price. Typically, overages are split between the financial institution and the originator who obtained the overage.

-- How does the institution monitor overages? (ECOA, FHA)

Does the institution or the credit bureau(s) it uses assign risk ratings to applicants? (ECOA, FHA)

What type of loan fees does the financial institution assess and in what circumstances? (ECOA, FHA, Real Estate Settlement Procedures [RESPA], Credit Practices Rule [CPR], Truth in Lending [TIL], Flood Insurance [FI])

If adverse action on a loan application is recommended or taken, under what circumstances, if any, would applicants undergo a second review? (ECOA, FHA)

What circumstances prompt foreclosure or repossession proceedings? Do the institution's policies reveal any potential for prohibited disparate treatment? (ECOA, FHA)

Does the institution sell to or purchase loans from other business organizations (for example, loan brokers or car dealers)?

-- If so, does the financial institution make the final credit decision?

**LOAN
POLICIES
(cont'd)**

-- Does the financial institution establish or otherwise control the lending standards?

-- Is there a written agreement between the seller/buyer and the financial institution? (ECOA, FHA, CRA, Home Mortgage Disclosure Act [HMDA], CPR, Preservation of Consumers' Claims and Defenses [PCCD], RESPA)

Under what circumstances does the financial institution require or request a co-signer or guarantor? (ECOA, CPR)

What applicant characteristics would prompt the institution to offer or request the purchase of credit life insurance? (TIL, ECOA)

Under what circumstances does the financial institution require or request the applicant to obtain other types of insurance (for example, hazard, flood, auto)? (TIL, RESPA, FI)

Under what circumstances does the financial institution allow or make exceptions to its lending standards and policies? (ECOA, FHA)

Who is/are responsible for preparing and reviewing consumer disclosures?

Do the various loan departments within the financial institution accept applications or make loans that would normally be made by another loan department (for example, a commercial loan department making home purchase mortgages for customers as accommodation loans)?

**OTHER
POLICIES,
FILES, AND
PROGRAMS**

Review Other Policies, Files, and Programs

The following policies and files are requested in the CDR and will need to be reviewed.

Appraisal Policy

1. Review appraisal policies prior to review of the loan files.

2. Identify the circumstances when the financial institution requires:
An independent, professional appraisal

**OTHER
POLICIES,
FILES, AND
PROGRAMS
(cont'd)**

<p>An in-house staff appraisal</p> <p><i>NOTE: During the examination, review loan documents and adverse action notices to determine if the institution's appraisal policy is applied consistently.</i></p>
<p>3. Review the appraisal policy for possible indications of discrimination, including, but not limited to:</p> <p>Neighborhoods the institution identifies or indicates are undesirable</p> <p>Circumstances when appraisal fees are waived or refunded</p> <p>Any unusual pattern or practice related to the choice of a specific outside fee appraiser, or the decision to rely on in-house personnel</p>
<p>Branch Closing Policy</p>
<p>4. Review the institution's branch closing policy to ensure it satisfies all the regulatory requirements found in Section 42 of the FDI Act and the Policy Statement of Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision Concerning Branch Closing Notices and Policies.</p>
<p>Complaints File</p>
<p>5. Review copies of all consumer complaints filed against the financial institution since the previous examination to ensure that the institution has complied with all applicable consumer protection and civil rights laws and regulations.</p>
<p>Daily Statement of Condition</p>
<p>6. Review the daily statement of condition as a tool to assess the financial institution's asset and deposit structure as of the date of examination.</p> <p><i>NOTE: The daily statement may also be referred to as "balance sheet," "statement of assets and liabilities," or "general ledger," depending upon local preference.</i></p>
<p>7. Use the daily statement of condition to determine:</p> <p>Loan categories and relative relationships</p>

**OTHER
POLICIES,
FILES, AND
PROGRAMS
(cont'd)**

Loan-to-deposit ratio

Loan-to-total asset ratio

Equity investments that may be targeted to community development

NOTE: Equity investments and investments in municipal bonds for CRA purposes must meet the definition of a "Qualified Investment" as described in 12 C.F.R. 345.12(s).

Investments in municipal bond issues

Appraisal and loan origination fees

Advertising and marketing expenses

CRA Statement

8. Review the CRA Statements for applicable institutions.

As of January 1, 1996, small institutions and other institutions that opt to be evaluated under the revised regulation prior to July 1, 1997 are no longer required to maintain a CRA Statement

All other institutions are required to maintain a CRA Statement

NOTE: The CRA Statements for applicable institutions should be reviewed during PEP.

Public File

9. Review the CRA public file to determine if the applicable information for the particular institution is included.

For small institutions or other institutions that opt to be evaluated under the revised CRA regulation prior to the July 1, 1997 implementation date, refer to Section 345.43.

For all other institutions, refer to Section 345.5.

Compliance Program

10. Review the financial institution's compliance program and determine whether the program meets the minimum standards outlined in the Institution Compliance Programs Appendix of this manual.

**OTHER
POLICIES,
FILES, AND
PROGRAMS
(cont'd)**

Interest Calculation for Truth in Savings

11. Request System Defaults

It is recommended that a listing of (computer) system defaults be obtained from management to assist in the review of compliance with various regulations, including Regulation Z, Regulation CC, Regulation DD, etc.

For example, the following listing would provide the examiner with information such as:

Late fees are charged 15 days past the due date
Funds from U.S. Treasury checks are held 0 days
Interest calculations for deposit accounts are based on the average daily balance or daily balance method

The system defaults identified on this listing should be reviewed with actual policies, practices, disclosures, etc.

12. For the review of compliance with the Truth in Savings Act (TISA), determine if the institution calculates interest on the collected balance (as indicated by management on the CIR), request the required documentation from the TISA examination procedures during the initial stages of the examination.

**COMMUNITY
CONTACTS**

Community Contacts

1. Conduct community contact interviews with community members or organizations early in the examination process.

Where feasible, schedule contacts during PEP. This early contact will facilitate the interview process. Conducting the interview during the initial stages of the examination allows time to follow-up, when necessary, on information obtained from the community contacts.

Refer to the FFIEC Community Contact Policy for specific guidance.

**COMMUNITY
CONTACTS
(cont'd)**

A listing of previous contacts by the FDIC and other FFIEC agencies is distributed quarterly to each field office. Obtain copies of those forms from the field office files. Examiners may also contact the Community Affairs staff in the Regional Office for assistance in locating potential contacts.



**FDIC LAW,
REGULATIONS
, & RELATED
ACTS**

Applicable Rules

Fair Credit Reporting Act, Volume 2, Page 6601

Federal Trade Commission Regulations: Statement of General Policy or Interpretation of the Fair Credit Reporting Act, Volume 2, Page 7179

Part 338–Fair Housing, Volume 1, Page 2647

Part 339–Loans in Areas Having Special Flood Hazards, Volume 1, Page 2663

Part 345–Community Reinvestment Act, Volume 1, Page 2781

Part 3500–HUD’s Regulation X, Volume 3, Page 8855

Regulation B–Equal Credit Opportunity, Volume 2, Page 7209

Regulation C–Home Mortgage Disclosure, Volume 3, Page 7553

Regulation DD, Volume 2, Page 7429

Regulation Z–Truth in Lending, Volume 2, Page 6641

Section 42, Notice of Branch Closure, FDI Act, Volume 1, Page 1501

Staff Guidelines on the Credit Practices Rule, Volume 3, Page 7875

**Advisory
Opinions**

None

**Statements of
Policy**

Policy Statement of Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision Concerning Branch Closing Notices and Policies, Volume 2, page 5391



**DCA
MEMORANDA**

Closing Management and Board Meetings Policy, Transmittal No. DCA-96-09, dated 1/31/96

Examination Procedures for Advertisements and Public Notices, Transmittal # DCA-96-022, dated 2/22/96

Examination Procedures for Loan File Review, Transmittal # DCA-96-023, dated 3/1/96

Examination Procedures for Loan-Related Regulations, Transmittal # DCA-96-006, dated 1/19/96

General Workpaper Standards and Standardized Workpapers, Transmittal # DCA-96-003, dated 1/19/96

Initial Examination Activities, Transmittal No. DCA-96-011, dated 1/31/96

Instructions for the Compliance Report of Examination, Transmittal No. DCA-96-021, dated 2/23/96

Pre-Examination Planning (PEP) Procedures, Transmittal No. DCA-96-013, dated 1/31/96

**FINANCIAL
INSTITUTION
LETTERS (FIL)**

None

OTHER

FFIEC Community Contacts Procedures, Community Reinvestment Act Examination Procedures-and-Performance Evaluations, "Red Book", Tab K